

# Your *Trust* Matters

September 2024 Newsletter



**MidWestOne™**  
PRIVATE WEALTH



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## Empower Positivity through Awareness

Negativity bias is a psychological phenomenon where negative experiences exert a stronger influence on an individual's thoughts and behaviors than positive experiences of equal intensity. For investors in the stock market, understanding negativity bias is crucial because it can significantly affect decision-making, risk assessment, and ultimately, investment outcomes.

### Negativity Bias in Investing

In the context of investing, negativity bias manifests when investors give more weight to potential losses than to potential gains. This bias can lead to overly cautious investment strategies, premature selling of assets, or avoidance of high-reward opportunities due to fear of losses. Understanding this bias helps investors make more balanced and rational decisions.

### Historical and Evolutionary Roots

Negativity bias has deep evolutionary roots. Early humans who were more alert to threats and dangers had higher survival rates. This survival mechanism has persisted into modern times, making humans naturally more attuned to negative information. For investors, this means that negative news about the market or a particular investment can trigger strong emotional reactions and influence investment choices more than positive news.

### Implications for Investment Behavior

Negativity bias can have several implications for investment behavior, affecting how investors approach risk, diversify their portfolios, and respond to market volatility. Investors influenced by negativity bias tend to be more risk-averse, preferring safer, lower-yield investments over higher-risk, higher-reward opportunities. While this can protect against losses, it can also limit potential gains. Negativity bias can lead to overly conservative portfolio diversification, where investors may avoid sectors or assets perceived as risky, even if they offer higher returns. This can result in missed opportunities for growth and suboptimal portfolio performance. During periods of market volatility, negativity bias can cause investors to overreact to negative news, leading to panic selling and exacerbating market downturns. Conversely, positive news may not generate as strong a reaction, leading to slower recovery periods.

continued on page 2

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## Mitigating Negativity Bias

Investors can mitigate the effects of negativity bias through several strategies. Understanding the existence and impact of negativity bias can help investors recognize when it is influencing their decisions. Educating oneself about market trends, historical performance, and behavioral finance can provide a more balanced perspective. Cognitive-behavioral techniques, such as reframing negative thoughts and focusing on long-term investment goals, can help investors overcome negativity bias. By shifting focus from short-term market fluctuations to long-term trends, investors can make more rational decisions. Building a well-diversified portfolio that includes a mix of asset classes can help manage risk and reduce the emotional impact of negative market events. Regularly reviewing and adjusting the portfolio based on performance and changing market conditions can also mitigate the effects of negativity bias. Consulting with your wealth management team can provide objective insights and help counteract the emotional influence of negativity bias. Wealth advisors can offer strategies tailored to individual risk tolerance and investment goals, helping investors stay focused on long-term objectives.

## Conclusion

Negativity bias is a powerful force in the psychology of investing, influencing how investors perceive and react to market information. By understanding and actively countering this bias, investors can make more balanced, rational decisions, leading to better investment outcomes. Awareness, education, cognitive restructuring, diversification, and seeking professional advice are all effective strategies for mitigating the impact of negativity bias in the stock market.

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